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Pension accounting myth

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THE PENSION ACCOUNTING MYTH

Abstract: This paper traces the development of pension accounting theory and practice to 1930. It analyzes the early development of pension accounting theory and practice, examines explanations of the nature of pension costs, and reports the results of a survey of pre-1930 pension disclosure practices.

The Financial Accounting Standards Board's employer pension accounting project has been described as "one of the most important undertaken since the Board was established in 1973."[1] Analyses of the project follow a standard format of (1) describing the pension pronouncements of the Accounting Principles Board (APB), (2) discussing the pension reform legislation of the 1970s and 1980s, and (3) criticizing the FASB's proposals for change. Absent is any consideration of pension accounting theory and practices developed between the establishment of the first U.S. private, pension plan in 1875[2] and the 1966 *Accounting Principles Board Opinion No. 8.*[3] This omission underscores the myth that pension accounting theory and practice did not begin to develop until the advent of pension regulation.

To refute this myth, this paper reviews pension accounting theory and practice during the unregulated period prior to any pronouncement by the Accounting Principles Board, the securities laws (1933, 1934), the Social Security Act (1935), and much of the tax legislation directed at private pension plans (1928 and thereafter). This approach eliminates, or at least minimizes, the effects of regulatory influences.

The paper contains four sections each directed at one of the following questions:

(1) What factors affected the early development of pension accounting theory and practice?
(2) What theories existed to guide measurement and disclosure?

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(3) What types of pension disclosures were made?
(4) What can be learned from studying the historical development of pension accounting theory and practice?

Factors Affecting The Development of Pension Accounting Theory and Practice

The first formal, noncontributory pension plan was established in 1875 by the American Express Company.[4] Under the terms of the plan, employees sixty years of age or over who had worked continuously for the company for at least twenty years, and who were judged by the general manager to no longer be able to do their work, could be retired by the executive committee of the board of directors. The annual pension allowance was one-half of the employee's average annual pay during the 10 years preceding retirement, to a maximum of $500. Average annual pay being $439 for manufacturing employees and $560 for railroad employees,[5] most pensioners would have received less than $300 a year in benefits.

The number of new pension plans grew relatively slowly during the next fifty years. In 1929, there were only 397 pension plans operated in the U.S. and Canada. The growth rate accelerated over the next decade, and by March 31, 1945 over 7,500 plans had been submitted to the Bureau of Internal Revenue for advance rulings on their tax status.[6]

The growth of the private pension system was caused by industrialization and changing demographics. Procedures to account for these plans were influenced by (1) the types of plans, (2) employer motives for establishing the plans, (3) managerial philosophy, (4) financial considerations, and (5) legislation and judicial decisions.

Types of Plans

Early pension plans can be classified as informal or formal. In informal plans, there were no standards for granting benefits. Payments were made on the basis of the employer's assessment of need rather than using standardized criteria. Because of their lack of structure, there was rarely a written record of how these plans operated. Accordingly, it is difficult to determine the extent or importance of these plans.

Formal plans have written (or unwritten but consistently followed) rules governing eligibility requirements, computation of benefits, and other procedures. Annual reports and labor records often provide insights into the operation of these plans. With formal plans labor records usually show a steady rather than erratic pattern of employee retirements each year.

Within the category of what are now called defined benefit plans, formal plans are broadly classified as noncontributory or contributory. The former meant that the employee made no cash contribution to the plan and the latter that he contributed regularly from his cash wages.

Noncontributory plans were further distinguished as "discretionary" or "limited-contractual" plans. Employers sponsoring noncontributory "discretionary" plans had complete, unquestioned control over the general provisions of the plan, the amount of benefits, the continuance of the plan, and the continuance of the pension once payments began. This type of plan has been described as saying to the worker:

- If you remain with this company through your productive lifetime,
- If you do not die before the retirement age,
- If you are not discharged, or laid off for an extended period,
- If you are not refused a benefit as a matter of discipline,
- If the company continues in business, and
- If the company does not decide to abandon this plan,
- you will receive a pension at the age of ____, subject to the contingency of its discontinuance or reduction, after it has been entered upon.[7]

With one exception, this description also applied to "limited-contractual" plans. The exception was that under a "limited-contractual" plan, pension payments to an employee could not be discontinued once they were begun. A 1922 study of eighty-seven noncontributory plans indicated that only twenty-seven were "limited-contractual" plans.[8]

In the majority of noncontributory plans, computation of benefit payments was directly related to an employee's pay during the final years of his service to the employer.[9] This type of plan, commonly called a final pay plan, is still prevalent today.[10]

Motives and Managerial Philosophy

The discretionary nature of early pension plans suggests that payments made under these plans may have been viewed as gifts or rewards. This conclusion is supported by early plan descriptions which characterize pension payments as "voluntary gifts from the company"[11] but it is at odds with analyses of employers' motives for establishing pension plans.

A 1922 critique of industrial pension plans lists five motives for establishing a plan.

- A desire to provide for the old age dependent, superannuated employees.
- A desire to reward employees who have rendered unusually long service.
- A desire to increase efficiency, first by the elimination of superannuated or incapacitated workers on a humane basis and, second, by stimulating the good will and effort of the active force.
- A desire to hold the worker to the job, thereby reducing labor turnover.
- A desire to exercise a disciplinary control over workers in response to strikes and in other ways.[12]

After lengthy discussion, the critique concludes that the "one controlling justification of a pension system from the employer's standpoint is that it will increase efficiency, primarily through elimination of superannuated and incapacitated workers, and possibly by building up a larger amount of good will and interest among the active force."[13] This conclusion is supported by the fact that formal pension plans developed most rapidly in industries (e.g., railroads, heavy manufacturing) in which older workers normally would not have the physical strength or agility to perform the physical tasks required by their jobs.

Economic factors also were used to explain why the majority of employers established noncontributory rather than contributory plans. One critic provided the following analysis:

> If the dominating influence were the desire for a humane method of retirement, there would seem to be no reason against the employees contributing to a fund and having a voice in administration. That they do not do so leads to the conclusion that the railroads have preferred to bear the entire cost in order to retain full control of the schemes. This policy has the advantages, at least in the opinion of the management, of not complicating relations with trade unions, retaining full control of retirements and final judgment on the fulfilling of qualifications, discouraging strikes, and permitting retirement for the good of the service and the public safety.[14]

The emphasis on economic efficiency indicated in the foregoing quotes is consistent with a management philosophy of the early part of the twentieth century referred to as scientific management. Proponents of this philosophy looked at business organizations from a highly mechanistic view and saw workers as tools for achieving rational, profit-maximizing goals.[15]

Although employers viewed pension plans as a means of improving labor productivity, the general attitude of workers toward early pension plans was one of indifference or distrust. Labor leader Samuel Gompers described organized labor's position as follows:

> Labor does not believe in pensions given by the employer. Old age pensions were established by a number of railroad companies, not for the benefit of their employees primarily but for the influence they might have on discouraging organization. . . .[16]

Labor's negative attitude toward pensions, which continued until the cash wage freezes of the 1940s, supports the contention that early pension plans were designed to meet the economic needs of the employer rather than those of the employees.

Financial Considerations

Concern for the financial health of industrial pension plans surfaced early. In 1922, for example, Conant stated, "very few of the industrial pension plans in the United States today are so financed that they are likely to remain solvent without refinancing or modification."[17] Latimer's study concluded, "the great majority of pension plans in American industry have been established with no accurate calculation of their future costs and with no adequate provision for financing them."[18]

Factors cited as contributing to these problems included (1) absence of actuarial calculations of prospective payments, (2) failure to establish segregated pension funds, and (3) the use of salary-related benefit formulas.

Legislation and Court Decisions

Employers had almost total discretion in the administration of early pension plans. Initially, this discretion was not an issue of public policy. The early tax laws, for example, did not require nondiscrimination in the payment of benefits or irrevocability of contributions as conditions for the tax deductibility of pensions paid to retired employees or contributions to a trust to fund current pension credits. They also did not permit the deduction of payments to a trust to fund credits for past service or to put the trust on a sound financial basis. The latter type of deduction was first permitted by the Revenue Act of 1928.

The right of employers to unlimited discretion in plan administration was supported by a series of court decisions. The main question adjudicated was whether the offer of a pension constituted an agreement to pay when specified conditions were fulfilled or whether it was merely an offer of a gratuity which could be withdrawn by the employer at will. Since there was no statutory law on the subject, early court decisions represented the only source of authority on the contractual status of a pension arrangement. Latimer's analysis of major cases prior to 1930 concluded "the trend of the law so far has been to say to industry that it make its own law for pensions. The court will take the pension plan as the statute in each case and decide in accordance with it."[19] This meant that the amount due was generally not deemed to be compensation and the fullfillment by the employee of his part of the agreement was not regarded as the consideration necessary for completion of a contract.

Implications for Accounting

The factors reviewed in the preceding subsections have conflicting implications for the development of pension accounting theory and practice. On the one hand, the emphasis on economic efficiency, scientific management, and the financial health of pension plans provided incentives for the development of fairly detailed records to determine the cost of providing pension benefits. On the other hand, however, the emphasis on employer control of pension plans shown by managerial practices, court decisions, and tax laws would have militated against the development of relatively uniform and consistently applied accounting rules.

The next two sections indicate how this conflict was resolved. The first examines the early pension-related accounting literature, and the second, the pension accounting practices that evolved.

Development of Pension Accounting Theory

Two theories were developed to explain who bears the cost of providing pension benefits. One, the deferred wage theory, argued that employees actually financed their own pensions by accepting pension promises in lieu of cash wages. The other contended that it was the employer who bore the entire cost of the plan.

The deferred wage theory is based on the premise that pension promises are part of the total compensation package offered employees. Since the total value of the compensation package is fixed by the market, an increase in the pension component would be offset by a decrease in the cash wage. An early proponent of the deferred wage theory argued, "a pension system considered as part of the real wages of an employee is really paid by the employee, not perhaps in money, but in foregoing an increase in wages which he might obtain except for the establishment of a pension system."[20]

The Illinois Pension Laws Commission reached a similar conclusion. Their report noted,

> It is the opinion of students of the pension problem that the existence of a pension system in connection with any position of employment is taken into account by both parties to the contract of employment, and that broadly speaking, wages and salaries actually paid are in due course reduced below what they otherwise would be by the amount of the total contributions from both the employer and employee to a pension fund. The employee will thus pay for his pension by deductions from his wages or salary, whether he is conscious of it or not.[21]

The competing theory refutes this position and argues that a pension contribution is similar to a charge for depreciation or insurance. A proponent of this view noted:

> in so far as such a payment is for insurance against that waste and inefficiency in his establishment which would result from retaining superannuated employees and for protection against that discontent which would result from discharging the superannuated without providing for them financially, it is part of the business expense.[22]

A similar position to the latter was adopted in the first pension accounting article to appear in the *Journal of Accountancy*. To the author, pension plans were an operationalization of the philosophy of scientific management. Employers bore the additional cost of the plans because they expected them to help increase profitability. However, the cost was not viewed as a production cost. Rather, it was viewed as a separate charge against income, or a form of profit-sharing. Appropriate accounting meant that "pensions should be provided for in a reserve, during the period of activity of the employee, and, like Bonus and Profit-sharing, be treated as a regular expense of business."[23]

Hatfield also advocated including among expenses "the amount necessary to provide for future pensions."[24] In addition, he questioned whether employers with pension plans should recognize a balance sheet liability. He concluded that the answer depended on "the exact legal nature of the pension agreement and on the financial policy adopted in its administration."[25] He argued that unless a definite legal liability existed, an amount equal to the sum in the pension fund, should be regarded as a reserve rather than a liability.

Hatfield noted that if annual contributions were made to a trustee, neither assets nor a reserve needed to be shown on the balance sheet. He reasoned that in such cases the payment of wages consisted of two parts: a cash wage paid to the workman and a cash contribution made to the trustees. According to Hatfield, no further accounting was necessary after the cash payments were recorded.[26]

Like Rand and Hatfield, Whitmore recommended accrual accounting for pensions. His recommendation was based on the premise that pension promises are part of the total cost of labor. In a 1927 *Journal of Accountancy* article, highly critical of industrial pensions, he argued,

> The real troubles are lack of actuarial calculations and of funding; or in plainer words, ignorance of the long-continued increase and the ultimate annual burden of pension payments, and neglect of the principle that the cost of pensions, as a part of the cost of labor, needs to be accrued, year by year throughout the years in which labor is performed.[27]

Whitmore intended for each year's cost accrual to be fully funded. He reasoned that to do otherwise would render the plan financially unsound and understate the cost of production.

A subsequent article by Whitmore focused on the implications of the deferred wage theory of pensions. Whitmore argued that "it is fairly certain that what the workers receive as pensions they will not receive as wages. And there is this great difference, that wages are likely to be fairly distributed as earned, and pensions are not."[28] Whitmore thought that employers should raise cash wages to allow employees to provide for their own retirement rather than promising pension benefits. He concluded his arguments by predicting the eventual demise of industrial pensions:

> [employee savings plans] would accomplish far more good than pension systems, at least in manufacturing industry, and be free from all of the evils affecting both employer and employees, that seem inseparable from pension systems.
>
> It is, therefore, through rising wages based upon accounting measurements of economies in manufacturing, and through the maximum encouragement and scientific management of savings, . . ., that I believe the need for pension systems in manufacturing industry should gradually cease.[29]

In contrast to Whitmore, Kimball supported the proposition that pensions are necessary to maintain efficiency in a continuously operating organization. He criticized the practice of charging pension payments to a supplementary payroll and treating them as a period operating cost. He argued pension cost was a production cost and that it was "logically inescapable that production cost is properly chargeable at the time goods or services entering into production are used, and not at the time they are paid for."[30] The amount of pension cost would be "the present worth of the future pension liability arising in any year out of that year's service."[31] In other words, it would be an amount equal to the normal cost of an actuarial cost method that took into consideration factors such as mortality, turnover, and future salary levels.

Although Kimball advocated annual pension accrual, he did not advocate the segregation of assets in a separate pension fund. He argued, "sound pension accounting and sound pension practice do not require the segregation of the money out of which pensions will eventually be paid, any more than the meeting of other obligations requires the segregation of money for its liquidation."[32] He reasoned that showing a balance sheet reserve was sufficient.

Kimball attributed the lack of attention given to pension accounting by employers to the fact that pension plans are non-contractual. He supported this statement by noting that "many executives of important businesses, which have for years made regular disbursements, have told me that since the pension was a voluntary matter, determined in amount and terms at the date of grant, future pension payments did not constitute an obligation that could properly be considered a balance-sheet item."[33] Kimball acknowledged the technical accuracy of this position, but advocated reporting the pension reserve as a liability in the balance sheet.

Dicksee discussed the use of reserves in accounting.[34] His discussion distinguished reserves and reserve funds. A reserve was "a provision charged against profit with a view to covering an expected loss."[35] Although Dicksee used the term loss in his definition, his example of creating reserves for the estimated amount of uncollectible accounts suggests that his use of the term encompasses provisions for estimated expenses. Thus, the creation of a reserve involved a debit to an expense or loss account and a credit to a reserve account.

Dicksee indicated that the reserve should be treated as a deduction from the particular asset in respect of which it was created or as a liability if created to cover a general loss (estimated expense) in respect to all assets. Although Dicksee did not specifically address the use of reserves in pension accounting, it appears as though a pension reserve would have been shown as a liability rather than a deduction from a specific account such as cash.

In contrast to a reserve, a reserve fund was "a sum set aside out of divisible profits, and retained in hand for the purpose of strengthening the financial position of the undertaking."[36] A Reserve Fund is but a portion of the credit balance of the Profit and Loss Account, which has been specifically "earmarked" as being "reserved."[37] Inclusion of a Pension Fund Reserve in the balance sheet indicated to shareholders that the fullfillment of pension promises would make a certain amount of earned surplus unavailable for the payment of dividends. In other words, it indicated there was an appropriation of retained earnings.

A Survey of Pension Disclosures

Pension accounting practices of employers prior to regulation have not been well documented. The fact that published articles argued how pensions should be accounted for suggests that practicing accountants may have been using a variety of approaches. To gain insights into the pension accounting and disclosure practices of employers, a sample of companies sponsoring pension plans in the early twentieth century was selected from a list of companies starting pension plans before 1922.[38] From this list, it was possible to locate sets of pre-1930 annual reports for the following companies: American Sugar Refining Company, American Smelting and Refining Company, J. I. Case Threshing Machine Company, Colorado Iron and Fuel Company, Deere and Company, Diamond Match Company, International Harvester, Pittsburgh Coal Company, and U.S. Steel. The annual report for each company for each year available was examined for pension disclosures.

Table 1 summarizes the results of the examination.* It indicates the types of disclosures the individual companies made. The majority of the companies studied tended to provide quantitative and relatively detailed qualitative pension disclosures. Only three of the companies (Colorado Fuel and Iron, J. I. Case Threshing Machine, and Diamond Match) did not provide disclosures that gave insights into the operation of their pension plans and the systems used to account for them.

In some cases, the disclosures voluntarily made provided basically the same information that was later required by regulation. For example, the 1911 annual report of the American Sugar Refining Company included a three page description of the provisions of the company's newly adopted pension plan. The description indicated who would receive benefits, how they would be earned, and how the amounts of benefits would be computed. This type of information, which also was disclosed voluntarily by American Smelting, International Harvester, and U.S. Steel, is what the federal government now requires in summary plan descriptions filed with the Department of Labor under the Employee Retirement Income Security Act.

Although several companies discussed the computation of pension cost, it was frequently difficult to determine how the cost was computed. Rather than discussing cost in their narrative disclosures, the companies tended to focus on absolute amounts, e.g., how many employees were receiving benefits; how much did they receive during the current period and to date; and how much was appropriated for the plan.

The majority of the companies used a reserve to account for their pension commitments. Figure 1 shows the pension reserve disclosures made by International Harvester in its 1918 annual report. A reconciliation of beginning and ending reserve balances was also provided in the annual reports of Pittsburgh Coal and U.S. Steel.

Several variations of reserve accounting existed. Journal entries for two of the variations are shown in Figure 2. Under both, the amount initially credited to the reserve was likely to be determined without the use of actuarial calculations. The amount credited to the reserve each year, if any, often was determined by the profitability of the company during the year. The reserve may have been designated as relating only to pensioners or as relating to the active work force as well as pensioners. The practice of pension reserve

*Copies of the detailed analyses of disclosures for each year are available from the author.

Table 1

Some U.S. Pension Disclosure Practices Prior to Regulation

TYPES OF DISCLOSURES	American Sugar Refining Co.	American Smelting & Refining Co.	Deere & Co.	International Harvester	Pittsburgh Coal Co.	U.S. Steel
Quantitative Disclosures						
• Pension investments as assets	X	X		X	X	
• Pension reserve on right hand side of balance sheet	X	X	X	X	X	X
• Some measure of pension cost*	X	X		X	X	X
• Detailed analysis of changes in reserve account included in financials				X	X	X
Qualitative Disclosures						
• Employer's pension philosophy	X	X		X		
• Plan description	X	X		X		X
• Discussion of plan changes	X	X		X		
• Number of pensioners	X	X		X		X

*Measure generally is not the result of an actuarial cost method consistently applied—see discussion.

accounting was followed by large companies, such as U.S. Steel, throughout the war years and into the 1950s.

With variation 1 (Figure 2), the entry to create the reserves was simply a reclassification. In effect, it was an appropriation of earned surplus (i.e., retained earnings). According to Dicksee, the credit should have been to Pension Reserve Fund rather than Pension Reserve. However, the companies studied did not always make this distinction. A companion entry may or may not have been made to segregate cash in a special fund. If a fund was established, earnings of the fund were used to pay pensioners. To the extent that fund earnings were insufficient to cover payments or if no fund existed, pension payments were recorded as a charge to operating expense. Debiting pension expense for the amount paid to pen-

Figure 1
1918 Pension Disclosures of International Harvester

RESERVES

Pension Fund:
A permanent Pension Fund is established by annual appropriations from earnings, to be continued until its amount is sufficient to provide the income necessary for future payments. Pensions are paid by the Company without any contribution from employees. The appropriation made by the directors from 1918 earnings was $1,000,000, which has been invested in Liberty Bonds.

On January 1, 1919, the pension plan rules were amended to conform more closely to changed living conditions. The minimum pension was increased from $21 per month to $30 per month. The maximum pension was increased from $100 per month to $208.33 per month, with the limitation that in no case shall a pension exceed one-half of the average annual pay. The Pension Board was authorized to increase the rate of monthly payment to pensioned employees from 1% to 1½% of the average annual pay for each year of active service; also to make the basis of calculating the average annual pay the consecutive ten year period in which the employee received the highest pay, instead of the last ten years of service, as heretofore. These changes will materially increase the total annual pension distribution. At December 31, 1918, there were 365 former employees on the pension roll.

Balance at December 31, 1917:	
International Harvester Co. of New Jersey	$2,336,762.94
International Harvester Corporation	856,092.57
	$3,192,855.51
Add:	
Income from Fund for year 1918	157,107.49
Appropriation from 1918 Earnings	1,000,000.00
	$4,349,963.00
Deduct:	
Pension payments during 1918	112,572.00
Balance at December 31, 1918	$4,237,391.00

Source: International Harvester Company, 1918 Annual Report, p. 13.

sioners was referred to as pay-as-you-go accounting, a practice followed almost exclusively by railroads.

In unprofitable years, the company could use cash from the pension fund (if one existed) and reclassify the pension fund reserve as earned surplus. As long as the pension fund and pension fund reserve existed, they were normally reported on the balance sheet. The fund was reported as an asset while the reserve was carried in a separate section usually as a segregation of earned surplus. Figure 3 shows the 1917 balance sheet disclosures of the American Sugar Refining Company.

Figure 2
Journal Entries for Reserve Pension Accounting

Entry	Variation 1			Variation 2		
To establish	Earned Surplus	XX		Pension Reserve		
or increase	Pension Reserve			Expense	XX	
the pension	Fund		XX	Pension Reserve		XX
reserve						
To purchase	Investments,			Investments, Pension		
investments,	Pension Fund	XX		Fund	XX	
if plan funded	Cash		XX	Cash		XX
To record	Cash	XX		Cash	XX	
investment	Pension Reserve			Pension Reserve		XX
earnings	Fund		XX			
To record	Pension Reserve			Pension Reserve	XX	
payments	Fund	XX		Cash		XX
to pensioners	Current Operating					
	Expense	XX				
	Cash		XX			

With variation 2 (Figure 2) pension expense was charged each time the reserve was increased. If the increase was related to the assumed cost of pensions earned during the year, the employer was accruing pension costs. If an increase was made only in profitable years, however, the concept of accrual accounting was violated and the reserve served as a means of smoothing income. Under this variation, pension payments generally were charged to the reserve rather than expense. The pension fund, if any, was reported as a balance sheet asset and the reserve was included with long-term liabilities, frequently as part of an amount captioned general reserves.

A number of companies provided detailed analyses of their pension funds until around 1928. Figure 4 shows a pension fund statement from the 1922 annual report of Pittsburgh Coal Company. The fund statement agreed with the company's financial statements. The $216,004.98, indicated by (1), was carried as a noncurrent asset on the balance sheet. The $215,301.77, indicated by (2), was shown as a gross receipts deduction in the profit and loss statement.

In 1928 pension funds and reserves began to move off the balance sheet. The prime factor associated with this movement was the Revenue Act of 1928. This act permitted an employer to take deductions for reasonable amounts paid in to a qualified trust in excess of the amounts required to fund current liabilities. This

Figure 3
1917 Balance Sheet of The American Sugar Refining Company and Its Constituent Companies

The American Sugar Refining Company

and Its Constituent Companies
Condensed General Balance Sheet, December 31, 1917

ASSETS:

Real Estate and Plants, including Refineries, Warehouses, Cooperage, Railroads, Tank Cars, Wharves and Stables, with their machinery and equipment, and timber and other lands owned in fee or through ownership of the entire Capital Stock of constituent companies, at cost less depreciation		$45,931,123.93
Investments, General		24,782,540.68
Investments, Insurance Fund		9,500,000.00
Investments, Pension Fund		1,750,000.00
Merchandise and Supplies, including raw and refined sugar, syrup, material in process of manufacturing, boneblack, cooperage and other stock and supplies on hand		9,142,074.71
Prepaid Accounts, Insurance, Taxes, Etc.		309,051.18
Loans		1,121,266.10
Accounts Receivable		3,322,489.23
Accrued Income, Interest earned and dividends declared but not yet collected		1,047,043.91
Cash on hand, with Trust Companies, Banks and Short-term Loans		40,493,252.19
		$137,398,841.93
Capital Stock:		
Preferred $45,000,000.00		
Common 45,000,000.00		$90,000,000.00
Sundry Reserves:		
For Insurance	$9,500,000.00	
For Pension Fund	1,750,000.00	
For Improvement of Plants	3,367,514.84	
For Trade Mark Advertising	2,000,000.00	
For Contingencies	823,647.99	
		17,441,162.83
Accounts, Taxes and Loans Payable		8,097,115.45
Dividends declared payable January 2, 1918, and former dividends unclaimed		1,599,036.75
Surplus:		
Balance December 31, 1916	$18,348,711.69	
Add Amount transferred in 1917 as stated in Income and Profit and Loss Statement	1,912,815.21	20,261,526.90
		$137,398,841.93

Figure 3 (continued)
1917 Balance Sheet of The American Sugar Refining Company and Its Constituent Companies

The American Sugar Refining Company

and Its Constituent Companies
Income and Profit and Loss Statement for the Year 1917

CREDITS:			
Profit from Operations			$10,055,291.41
Interest on Loans and Deposits			1,006,002.25
Income from Investments, less Decrease in Market Value of Bonds, and of Securities held for temporary investment			3,129,948.70
Net Profit from Investments			21,544.85
			$14,212,787.21
DEBITS:			
For Depreciation, Renewal or Replacement of Plant and Equipment		$2,000,000.00	
For Appropriations to Reserves as follows:			
Insurance Fund	$500,000.00		
Improvement of Plants	2,000,000.00		
Trade Mark Advertising	1,000,000.00		
Pension Fund	500,000.00		
		4,000,000.00	
For Dividends declared during 1917		6,299,972.00	12,299,972.00
Balance added to Surplus			$1,912,815.21

We have examined the books and accounts of The American Sugar Refining Company and the statements of the several constituent companies, and verified the cash, the loans and the securities owned. The foregoing Condensed General Balance Sheet and Income and Profit and Loss Statement agree with the said books and accounts. We are of the opinion that ample reserves have been made for depreciation or for renewal and replacement of fixed assets and for other purposes, including taxes; that the value of the investments, as a whole, is conservatively stated and the foregoing Condensed General Balance Sheet presents the true financial position of the corporation and its constituent companies on December 31, 1917.

GEO. H. CHURCH, C.P.A.,
DELOITTE, PLENDER, GRIFFITHS & CO., } *Auditors*

New York, February 11, 1918

Source: The American Sugar Refining Company, 1917 Annual Report, pp. 22-23.

Figure 4
Detailed Pension Disclosures from the 1922 Annual Report of Pittsburgh Coal Company

MINE EMPLOYEES' PENSION FUND

Cash on Hand at January 1, 1922		$ 8,348.54
RECEIPTS		
Company and Employees Contributions	$ 6,217.92	
Interest and Dividends from Investments	18,525.33	
	24,743.25 (3)	
DISBURSEMENTS		
Pensions Paid	33,795.00	
Decrease during year	9,051.75	
Less—Advance from Employees' Relief Department	703.21	
		8,348.54
Cash Balance at December 31, 1922		— —
INVESTMENTS AT DECEMBER 31, 1922		
3000 Shares Preferred Stock of the Company—cost	$211,004.98	
4¼% United States Liberty Loan Bonds—	5,000.00	
		$216,004.98 (1)
Less—Advance by Mine Employees' Relief Department		703.21
Balance at Credit, December 31, 1922		(2) $215,301.77

NUMBER OF MINE EMPLOYEES RECEIVING PENSIONS

At January 1, 1922		166
Added during year	37	
Deaths during year	18	
		19
At December 31, 1922		185

Source: Pittsburgh Coal Company, 1922 Annual Report, p. 22.

meant that, for the first time, employers were able to take deductions for payments to fund past service liabilities. The employers in the current study responded to this incentive by transferring their balance sheet reserves to a trust.

The following explanation was provided in the 1928 annual report of International Harvester.

> On December 13, 1928, the directors approved the trusteeing of the Pension Fund and before the issuance of this report a Pension Trust was executed and Fund assets transferred to trustees. Accordingly, the Pension Fund and the contra reserve have been omitted from the balance sheet.
>
> The heavy future obligation involved in the maintenance of a pension plan can be safely financed only by setting aside during the employee's productive years the fund to pay his pension after retirement. The Company follows this plan and the Pension Fund assets now trusteed are required to meet the estimated accrued pension liability at December 31, 1928. It is expected that such additional amounts as the directors may hereafter appropriate for pension purposes will also be transferred to the Pension Trust.

Establishment of a trust allowed an employer to take advantage of tax incentives, but the then current laws did not require that the trust be irrevocable. This meant that an employer could make substantial tax deductible contributions to a trust during years of high earnings and recapture the earnings in poor years by revoking the trust. The requirement that pension trusts be irrevocable did not become law until the Revenue Act of 1938. Nonetheless, the establishment of trusteed plans was associated with a decrease in voluntary pension disclosures.

Summary and Conclusions

This paper refutes the myth that pension accounting theory and practice developed after the advent of regulation. By 1930, competing pension theories had been articulated and a body of pension accounting literature had begun to develop. The literature focused on the importance of the accrual of pension costs, a practice that was not mandated by the Accounting Principles Board until 1966. The early literature also raised the question of whether an employer's pension promises constituted an obligation that warranted balance sheet recognition, a question currently being debated by the Financial Accounting Standards Board.

Although early writers devoted little attention to the question of pension disclosures, a survey of pre-1930 annual reports showed that some of the companies studied made extensive pension disclosures. Before there was any external requirement to do so, employers disclosed relatively detailed information about the terms of their plans and the reserves accumulated for those plans. Although measures of pension costs were disclosed, explanations of their method of computation often were missing, or ambiguous.

Documentation of the existence of voluntary pension disclosures opens the door to a number of questions of potential interest to academic researchers and policy-makers. It may be useful to determine the motives for voluntary pension disclosure, and how these motives were affected by regulation.

FOOTNOTES

[1]Kirk, p. 1.
[2]Latimer, p. 21.
[3]AICPA (1966).
[4]Latimer, Vol. 1, p. 21.
[5]U.S. Department of Labor, Bureau of the Census, p. 168.
[6]Winslow, p. 9.
[7]Conant, p. 80.
[8]Conant, p. 89.
[9]Latimer, Vol. 1, pp. 102-156.
[10]Rosenbloom and Hallman, p. 287.
[11]Conant, pp. 50-51.
[12]Conant, p. 4.
[13]Conant, p. 45.
[14]Latimer, Vol. 1, p. 44.
[15]Kast and Rosenzweig, pp. 56-57.
[16]Conant, p. 40.
[17]Conant, p. 2.
[18]Latimer, Vol. 1, p. 101.
[19]Latimer, Vol. 2, p. 706.
[20]de Roode, p. 287.
[21]Conant, p. 54.
[22]Brandeis, pp. 67-69.
[23]Rand, p. 501.
[24]Hatfield, p.194.
[25]Hatfield, p. 194.
[26]Hatfield, p. 194.
[27]Whitmore (March 1929), pp. 181-182.
[28]Whitmore (April 1929), p. 244.
[29]Whitmore (April 1929), p. 251.
[30]Kimball, p. 166.

[31]Kimball, p. 171.
[32]Kimball, p. 167.
[33]Kimball, p. 168.
[34]Dicksee, pp. 47-56.
[35]Dicksee, p. 47.
[36]Dicksee, p. 51.
[37]Dicksee, p. 51.
[38]Conant, Appendix I.

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